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IN THE
Supreme Court of the United States

DURA PHARMACEUTICALS, INC. ET AL.,
Petitioners,

v.

MICHAEL BROUDO ET AL.,
Respondents.

On Writ of Certiorari to the United States Court of Appeals for the Ninth Circuit

BRIEF OF THE CHAMBER OF COMMERCE OF THE UNITED STATES AS *AMICUS CURIAE* IN SUPPORT OF PETITIONERS

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INTEREST OF THE *AMICUS CURIAE* [1]

The Chamber of Commerce of the United States (the "Chamber") is the world's largest business federation. The Chamber represents an underlying membership of more than three million businesses and organizations of every size, in every industry sector, and from every region of the country. The Chamber regularly advocates the interests of its members in court involving issues of national concern to the American business community.

The Chamber has a substantial interest in the issue presented in this case: the proper application of the loss causation principle in securities litigation. Securities class action litigation imposes an enormous toll on the national economy, affecting virtually every public corporation in America at one time or another and costing American businesses billions of dollars in settlements every year. Indeed, recent studies conclude that, over a five-year period, the average public corporation faces a 9% probability of facing *at least* one securities class action lawsuit. *See* Elaine Buckberg et al., NERA, *Recent Trends in Securities Class Action Litigation: 2003 Early Update* 4 (Feb. 2004) ("*2003 Early Update*"). As Congresswoman Anna Eshoo (D-Cal.) has put it, "Businesses in my region place themselves in one of two categories: those who have been sued for securities fraud and those that will be."[2]

Because of pressures unique to securities class action litigation, virtually all claims that survive initial motions practice are settled. With little prospect that their claims will be fully tested by the adversarial process, plaintiffs

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[1] Pursuant to Supreme Court Rule 37.6, counsel for *amicus* represents that they authored this brief and that no entity other than *amicus*, its counsel, or its members made a monetary contribution to its preparation or submission. All parties have consented to the filing of this *amicus* brief, and letters reflecting their consent have been filed with the Clerk.

[2] Conference Report on H.R. 1058, Private Securities Litigation Reform Act of 1995, 141 Cong. Rec. H14039, H14051 (Dec. 6, 1995).

have a strong incentive to bring securities class action claims without regard to their underlying merit. By diverting resources away from productive economic uses, meritless securities actions threaten to slow the spread of new investments, reduce the efficiency of capital markets, and limit the competitiveness of the American economy. The membership of the Chamber thus has a strong interest in ensuring that the requirements of the federal securities laws are applied in a correct and uniform manner, weeding out meritless suits as quickly and regularly as practicable, in order to avoid undue harm to the nation's commerce and industry.

SUMMARY OF ARGUMENT

While the statutory and legislative history arguments for reversal are familiar, what may not be so apparent is the practical impact of the Ninth Circuit's ruling in contemporary securities class action litigation. Simply put, the court of appeals' decision, if affirmed, would make what is already a bad situation very much worse.

First, due to pressures unique to American securities litigation, businesses are typically forced to settle even meritless suits. Unless a case can be dismissed through early motions practice, the subsequent threat of class certification forces corporate executives to choose between staking the future of their companies on the outcome of a single jury verdict, or settling even when they may have no legal liability.

Securities class action suits, moreover, often benefit class counsel more than they do class members, with settlement payments simply involving a transfer of wealth from current shareholders to former shareholders, minus, of course, contingent attorneys' fees that typically run between 19% and 45%. As one leading securities class action plaintiff's lawyer has candidly admitted: "I have the greatest practice in the world because I have no clients. I

bring the case. I hire the plaintiff. I do not have some client telling me what to do. I decide what to do."[3]

Second, into this environment the Ninth Circuit's holding introduces a new legal rule that only further encourages plaintiffs to file and companies to settle meritless claims by removing a key safeguard against such suits. Worse still, the Ninth Circuit's rule encourages risky investment behavior, effectively forcing issuers to insure against speculative losses having nothing to do with their own conduct. Under the Ninth Circuit's rule, an investor can file a claim and obtain recovery even when the disclosure of an allegedly fraudulent statement has absolutely *no effect* on the stock price. To estimate damages in the absence of any contemporaneous real world stock price movement, moreover, the Ninth Circuit's rule requires litigants (and courts) to resort to exactly the sort of "junk science" economics this Court has consistently discouraged. And because it permits claims for any allegedly false statement, without respect to demonstrated market injury, the Ninth Circuit's rule has the effect of chilling investment advice and reporting within the securities industry.

By contrast, the alternative loss causation rule endorsed by the Government, petitioners, and four circuits[4] would avoid all of these problems while ensuring full recovery of real losses, consistent with the established tort principle that, although "the consequences of an act go

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[3] *See In re Network Assocs., Inc. Sec. Litig.*, 76 F. Supp. 2d 1017, 1032 (N.D. Cal. 1999) (quoting attorney William S. Lerach).

[4] The court of appeals below acknowledged that this interpretation of the loss causation requirement differed from the standards articulated by the Third and Eleventh Circuits. *See Semerenko v. Cendant Corp.*, 223 F.3d 165 (3d Cir. 2000); *Robbins v. Koger Props., Inc.*, 116 F.3d 1441 (11th Cir. 1997). The court of appeals did not, however, cite or discuss the additional conflicting decisions of the Second and Seventh Circuits. *See Emergent Capital Inv. Mgmt., LLC v. Stonepath Group, Inc.*, 343 F.3d 189 (2d Cir. 2003); *Bastian v. Petren Res. Corp.*, 892 F.2d 680 (7th Cir. 1990).

forward to eternity, . . . legal responsibility must be limited to those causes which are so closely connected with the result." W. Page Keeton et al., *Prosser and Keeton on Torts* § 41, at 264 (5th ed. 1984).

ARGUMENT

I. THE PRESSURE TO SETTLE EVEN MERITLESS SECURITIES CLASS ACTIONS IMPOSES AN ENORMOUS TOLL ON THE AMERICAN ECONOMY

This Court has long recognized that securities fraud litigation presents "a danger of vexatiousness different in degree and in kind from that which accompanies litigation in general." *Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723, 739 (1975). Because the amount of damages demanded can be so great, corporations are frequently forced to forgo the adversarial process, settling even meritless suits in order to avoid the prospect of bankruptcy. Indeed, studies indicate that, unless a securities class action is dismissed on the pleadings, it is virtually certain to settle. *See* Elliot J. Weiss & John S. Beckerman, *Let the Money Do the Monitoring: How Institutional Investors Can Reduce Agency Costs in Securities Class Actions*, 104 Yale L.J. 2053, 2064 (1995); Woodruff-Sawyer & Co., *A Study of Shareholder Class Action Litigation* 25 (2002) (83% of securities fraud cases are resolved through settlement).

So great is the pressure on corporations to settle that, even when defendants *do* succeed in obtaining a trial court dismissal, the risk of losing on appeal can still lead to enormous settlements. By way of example, just earlier this year one securities defendant agreed to settle a pending class action for $300 million even *after* the suit was dismissed on the merits with prejudice in the trial court.[5]

[5] Jonathan Weil, *Win Lawsuit —and Pay $300 Million*, Wall St. J., Aug. 2, 2004, at C3.

To be sure, Congress has sought to address these problems, passing the Private Securities Litigation Reform Act ("PSLRA") in 1995 and the Securities Litigation Uniform Standards Act in 1998. Despite these efforts at reform, however, the number of securities class actions has not declined. *See* Laura E. Simmons & Ellen M. Ryan, Cornerstone Research, *Post-Reform Act Securities Lawsuits: Settlements Reported Through December 2003* (May 2004) ("*PSLRA Settlements*"). Quite the opposite, in fact, has occurred: in the six years since the enactment of the PSLRA, the mean number of securities fraud suits has risen by an astonishing 32%. *See* Michael A. Perino, *Did the Private Securities Litigation Reform Act Work?*, 2003 U. Ill. L. Rev. 913, 930. Another published study has concluded that, following the enactment of the PSLRA, public companies now face a nearly 60% *greater* chance of being sued by shareholders. *See 2003 Early Update*. And the dismissal rate of securities fraud lawsuits between 1996 and 2003 averaged only 8.4%, with dismissals in three of the 11 federal circuits averaging *just 4%*, a result that Congress hardly anticipated or intended. *See id.* at 5.

Just as the number of cases continues to rise despite congressional efforts to rein them in, class members all too often continue to find themselves in the unfortunate position of losing regardless of the outcome of these cases. Because payments come out of corporate coffers, securities class actions frequently involve only "a transfer of wealth from current shareholders to former shareholders." Janet Cooper Alexander, *Rethinking Damages in Securities Class Actions*, 48 Stan. L. Rev. 1487, 1503 (1996).[6] Thus,

[6] *See also* Frank H. Easterbrook & Daniel R. Fischel, *Optimal Damages in Securities Cases*, 52 U. Chi. L. Rev. 611, 638-39 (1985); *see also* Jennifer H. Arlen & William J. Carney, *Vicarious Liability for Fraud on Securities Markets: Theory and Evidence*, 1992 U. Ill. L. Rev. 691, 698-700; Donald C. Langevoort, *Capping Damages for Open-Market Securities Fraud*, 38 Ariz. L. Rev. 639, 650 & n.48 (1996); Perino, *Did the Private Securities Litigation Reform Act Work?*, 2003 U. Ill. L. Rev. at 921-22.

to the extent that class members still own shares in the company at the time of the suit (as they often do), "payments by the corporation to settle a class action amount to transferring money from one pocket to the other, with about half of it dropping on the floor for lawyers to pick up." *Id.* As Judge Friendly once remarked, securities fraud litigation carries the risk of "'large judgments, payable in the last analysis by innocent investors, for the benefit of speculators and their lawyers.'" *Blue Chip Stamps*, 421 U.S. at 739 (quoting *SEC v. Texas Gulf Sulphur Co.*, 401 F.2d 833, 867 (2d Cir. 1968)).

A recent case against Qwest Communications illustrates the phenomenon. There, plaintiffs' counsel sought to increase the pressure on defendants to settle by moving to freeze approximately $400 million of potential proceeds from a planned sale of a Qwest business unit.[7] The plaintiffs' lawyers claimed that the sale should be enjoined to ensure that the as-yet-to-be certified class (and its counsel) would get paid if they ultimately won the suit. But Qwest badly needed the proceeds from the sale to avoid bankruptcy.[8] The district court eventually denied the motion and expressly found that a freeze would not benefit all putative class members or the company, but only former shareholders and the attorneys.[9] According to the court, entering the injunction sought would likely have bankrupted the company and rendered worthless the stock of thousands of would-be class members who were still shareholders in Qwest.[10]

Securities class actions are also frequently filed so quickly after a stock price decline that any reasonable fac-

[7] *In re Qwest Communications Int'l, Inc. Sec. Litig.*, 243 F. Supp. 2d 1179 (D. Colo. 2003).

[8] Press Release, Qwest Communications, *Qwest Communications Statement In Response to Motion Filed by Milberg Weiss Bershad Hynes & Lerach LLP* (Nov. 4, 2002).

[9] *Qwest Communications*, 243 F. Supp. 2d at 1186-87.

[10] *Id.* at 1188.

tual investigation into the merits is simply impossible. By way of example, one court found it "peculiar that four of the lawsuits consolidated in this action were filed around 10:00 a.m. on the first business day following [the defendant's] announcement" and that "[m]ost of the complaints are virtually identical (including typographical errors)."[11] At the hearing on the defendant's motion to dismiss, the judge inquired "How did you get to be so smart and to acquire all this knowledge about fraud from Friday to Tuesday? . . . On Friday afternoon did your client suddenly appear at your doorstep and say 'My God, I just read in the *Wall Street Journal* about Travelers. They defrauded me,' and you agreed with them and you interviewed them and you determined that there was fraud and therefore you had a good lawsuit, so you filed it Tuesday morning, is that what happened?" The court noted that "[c]ounsel for the plaintiffs was not responsive to this line of inquiry."[12]

Efforts at reform notwithstanding, virtually all securities class action cases continue to be settled with little or no regard to their underlying merit. As Congress, the courts, and commentators have all observed, "[t]oo frequently, corporate decisionmakers are confronted with the implacable arithmetic of the class action: even a meritless case with only a 5% chance of success at trial must be settled if the complaint claims hundreds of millions of dollars in damages." H.R. Rep. No. 106-320, at 8 (1999).[13] The

[11] *Ferber v. Travelers Corp.*, 785 F. Supp. 1101, 1106 n.8 (D. Conn. 1991).

[12] *Id.* (brackets omitted).

[13] *See also West v. Prudential Sec., Inc.*, 282 F.3d 935, 937 (7th Cir. 2002) (noting scholarly concerns that "settlements in securities cases reflect high risk of catastrophic loss, which together with imperfect alignment of managers' and investors' interests leads defendants to pay substantial sums even when the plaintiffs have weak positions"); Victor E. Schwartz et al., *Federal Courts Should Decide Interstate Class Actions: A Call for Federal Class Action Diversity Jurisdiction Reform*, 37 Harv. J. on Legis. 483, 490 (2000) ("For defendants, the risk

magnitude of the continuing pressure to settle even strike suits is perhaps most clearly exposed by the fact that, since the PSLRA's passage, more than 2,000[14] securities fraud cases have been filed in federal court, yet defendants have taken less than 1% to trial.[15] As one observer commented over a decade ago in words equally applicable today, there is simply "*no appreciable risk* of non-recovery" in securities class actions. Janet Cooper Alexander, *Do the Merits Matter? A Study of Settlements in Securities Class Actions*, 43 Stan. L. Rev. 497, 578 (1991).[16] Merely "*[g]etting the claim into the legal system*, without more, sets in motion forces that ultimately compel a multi-million dollar payment." *Id.* at 569 (emphasis added). *Accord Hevesi v. Citigroup Inc.*, 366 F.3d 70, 80 (2d Cir. 2004) (noting "numerous courts and scholars have warned that settlements in large [securities] class actions can be divorced from the parties' underlying legal positions"); *Newton v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 259 F.3d 154, 164 (3d Cir. 2001) (discussing the "inordinate or hydraulic pressure on [securities fraud] defendants to settle, avoiding the risk, however small, of potentially ruinous liability").

of participating in a single trial [of all claims], and facing a once-and-for-all verdict is ordinarily intolerable.") (internal quotation marks omitted).

[14] *See* Stanford Law School & Cornerstone Research, Securities Class Action Clearinghouse, *at* http://securities.stanford.edu/companies.html.

[15] Richard Painter et al., The Federalist Society for Law and Public Policy Studies, *Private Securities Litigation Reform Act: A Post-Enron Analysis* 8 (2003), *at* http://www.fed-soc.org/pdf/PSLRAFINALII.PDF ("*PSLRA Analysis*").

[16] As the Second Circuit has observed, "[a]necdotal evidence tends to confirm [Professor Alexander's] conclusion. Indeed, [Melvyn I.] Weiss and his partner William S. Lerach of the Milberg firm have stated that losses in these cases are 'few and far between,' and they achieve a 'significant settlement although not always a big legal fee, in 90% of the cases [they] file.'" *Goldberger v. Integrated Res., Inc.*, 209 F.3d 43, 52 (2d Cir. 2000) (quoting *In re Quantum Health Res., Inc. Sec. Litig.*, 962 F. Supp. 1254, 1258 (C.D. Cal. 1997)).

It is well known, too, that the same few law firms bring the great bulk of these claims. One recent study found that, since the passage of the PSLRA, a single firm (recently split into two) has been involved as lead or co-lead plaintiffs' counsel in over 50% of securities class action settlements.[17] In the cases where competition for lead counsel status does emerge, accusations are sometimes exchanged by the plaintiffs' bar that one or another firm has offered to "pay off" competitors to withdraw their applications to serve as lead counsel, leading at least one court to observe that

> [w]hile over a dozen law firms participated early on in this litigation, only two filed proposals to represent the class, and only one of these proposals appears serious. This suggests an understanding or collaboration among plaintiff firms engaged in securities class action litigation that many would choose not to bid for this litigation . . . . The indicia of such cooperation raises serious doubts about the conditions of competition in this segment of the legal services industry.[18]

Commenting on the phenomenon of contemporary securities class action litigation, a Florida court described the whole process as "the class litigation equivalent of the 'Squeegee boys' who used to frequent major urban intersections and who would run up to a stopped car, splash soapy water on its perfectly clean windshield and expect payment for the uninvited service of wiping it off." *Fruchter v. Florida Progress Corp.*, No. 99-6167CI-20, 2002 WL 1558220, at *10 (Fla. Cir. Ct. Mar. 20, 2002).

[17] *See PSLRA Settlements* at 14 (discussing the Milberg Weiss Bershad Hynes & Lerach firm, now divided into two separate partnerships known as Milberg Weiss Bershad & Schulman, and Lerach Coughlin Stoia Geller Rudman & Robbins); *see also PSLRA Analysis* at 15-16.

[18] *In re California Micro Devices Sec. Litig.*, No. C-94-2817-VRW, 1995 WL 476625, at *4 (N.D. Cal. Aug. 4, 1995).

Simply put, despite Congress's clear intent and two efforts at reform, American business continues to contend with "precisely the sort of lawyer-driven machinations the PSLRA was designed to prevent." *In re BankAmerica Corp. Sec. Litig.*, 95 F. Supp. 2d 1044, 1050 (E.D. Mo. 2000) (criticizing the "outrageous" attempts of plaintiffs' counsel to commandeer the class action for their own benefit), *aff'd*, 263 F.3d 795 (8th Cir. 2001). The drain on the American economy and its global competitiveness is substantial. In the last four years alone, securities class action settlements have exceeded two billion dollars *per year*.[19] And the problem continues to grow. In 2002, the average price of settling a securities fraud claim rose to $24.3 million, a 68% increase from 2001. *See* Laura E. Simmons & Ellen M. Ryan, Cornerstone Research, *Post-Reform Act Securities Lawsuits: Settlements Reported Through December 2002*, at 3 (May 2003). In 2003, the average settlement value for accounting-related securities fraud cases reached $26.5 million. *2003 PricewaterhouseCoopers Securities Litigation Study* (rel. Aug. 2, 2004), *at* http://www.10b5.com/2003_study.pdf.

II. THE NINTH CIRCUIT'S RULE WOULD SIGNIFICANTLY EXACERBATE THE PROBLEMS AND INCREASE THE SOCIAL COSTS ASSOCIATED WITH MERITLESS SECURITIES CLASS ACTIONS

"The economics of sanctions starts from the proposition that the objective of a legal rule is to deter certain undesirable behavior without simultaneously deterring (too much) beneficial behavior." Easterbrook & Fischel, *Optional Damages in Securities Cases*, 52 U. Chi. L. Rev. at 612. The Ninth Circuit's rule disregards this fundamental objective in many notable and problematic respects.

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[19] *See PSLRA Settlements* at 1. In 2000 alone, the total value of securities fraud cases (adjusted for inflation) was estimated at $4.428 billion. *Id.* Settlements in 2001 were estimated at $2.1 billion, rising to $2.537 billion in 2002, and holding at $2.016 billion in 2003. *Id.*

A. Rather than holding companies liable for the damage they inflict, as reflected by actual market events, the Ninth Circuit's rule permits liability to be found and damages to be awarded even when the plaintiff can point to *no actual market price reaction to a corrective disclosure*. By way of example, suppose a plaintiff buys $50 of stock in the defendant corporation. As time passes, the value of the plaintiff's investment declines to $5. *After* this decline, the defendant announces the restatement of an accounting item, yet the plaintiff's shares remain at $5. In most circuits, any subsequent securities class action would be dismissed. By contrast, under the Ninth Circuit's rule, a plaintiff can proceed to trial simply by hiring an expert to render an opinion on how much of the price the plaintiff paid was "inflated" because of the undisclosed accounting issue. Plaintiffs and their lawyers, thus, can obtain a recovery even where investors are not demonstrably hurt by the alleged fraud — including in cases where the plaintiffs sold before the alleged misrepresentation was exposed, or the misrepresentation was never exposed at all, or it was exposed but the market did not respond negatively.

Such a regime serves only to exacerbate the already-intense pressure on companies to settle securities class action suits without regard to their merit. Denying courts any means for weeding out at the pleading stage suits where the alleged fraud had no empirical effect on share price, and thus imposed no demonstrable harm on class members, the Ninth Circuit's rule adds fuel to a fire in which virtually every case is settled, wealth is transferred away from current shareholders and productive economic uses to former shareholders, and lawyers are enriched.

The facts of this case are illustrative. On February 24, 1998, Dura announced a revenue shortfall for the following year, unrelated to any alleged fraud. By the next day, shares in Dura dropped from $39.125 to $20.75 for a one-day loss of 47%. Some *nine months later*, on November 3, 1998, Dura announced for the first time that the United

States Food and Drug Administration had declined to approve its Albuterol Spiros product — an announcement that plaintiffs contend constitutes the first public disclosure of the alleged fraud in this case. Following this announcement, however, Dura shares fell only slightly and briefly. Share prices initially dropped from $12.375 to $9.75, but, within 12 trading days, they recovered to $12.438, ultimately climbing to $14.00 within 90 days of the announcement.

Plaintiffs in this suit, however, never alleged damages based on the brief and shallow $2.625 stock price dip after the November 3 disclosure of the supposed fraud. Rather, they demand recovery based on the much more significant February 24 stock price decline of $19, even though plaintiffs themselves allege no corrective disclosure in that announcement. In short, plaintiffs in this case seek damages based on a decline in share value that occurred nine months *before* the disclosure of the alleged fraud. And it is beyond cavil that a company facing potential liability of $19 per share is in a wildly different posture when it comes to deciding whether to litigate or settle than one facing potential liability of, at most, $2.625 per share.

B. Relatedly, the Ninth Circuit's rule dangerously skews investment incentives. To be sure, speculative investments are a natural — and even beneficial — part of any free and open market: "[I]n stock trading, as elsewhere, speculation serves the salutary purpose of enabling the rapid adjustment of prices to current values." Richard A. Posner, *Economic Analysis of the Law* 458 (6th ed. 2003). Because "[t]he speculator is the eager searcher for undervalued and overvalued securities," information discovered through this search "diffuses rapidly throughout the market." *Id.*

In particular, speculators may be attracted to what economists refer to as "rational bubbles," where a stock's price incorporates all publicly available information without "represent[ing] the true [market] value of the underlying company." Paul A. Ferrillo et al., *The "Less Than" Efficient Capital Markets Hypothesis: Requiring More Proof from Plaintiffs in Fraud-on-the-Market Cases*, 78 St. John's L. Rev. 81, 114 (2004). Investors might reasonably conclude that an overvalued stock will continue to appreciate during the life of the bubble. *See id.* at 115. These investors realize that "[e]ventually the bubble will burst, of course, but it is always a fair investment until that point." *Id.*

Naturally, the significant potential benefits of speculation also carry a correspondingly high degree of risk. Under the Ninth Circuit's rule, however, much of that risk is transferred away. If the price of a stock investment declines, the speculator can state a claim for relief, and likely obtain a significant settlement, merely by alleging that the defendant made a "misleading" statement — and do so even if the stock failed to decline after a corrective disclosure and moved downward only much later after other news. Such a regime unnaturally encourages risky investments by underwriting speculative losses unrelated to the defendant's conduct, and effectively serves to transform the federal securities laws into "a system of investor insurance that reimburses investors for any decline in the value of their investments." *Robbins*, 116 F.3d at 1447.

C. The Ninth Circuit regime also encourages, and in fact depends upon, a return to the use of "junk science." Because the Ninth Circuit's rule allows recovery where disclosures do *not* prompt any stock price decline, plaintiffs' experts are, by necessity, forced to resort to a grab-bag of speculative theories to estimate damages; and without any negative market reaction to the actual disclosure there is simply no objective way for courts, juries, or opposing parties to check their work. *See Robbins*, 116 F.3d at 1448.

Such a result stands in marked contrast with the Court's repeated attempts to remove precisely this sort of speculation about damages from the federal court system.

Cf. General Elec. Co. v. Joiner, 522 U.S. 136 (1997); *Kumho Tire Co. v. Carmichael*, 526 U.S. 137 (1999); *Daubert v. Merrell Dow Pharms., Inc.*, 509 U.S. 579, 579 (1993). Indeed, the same concerns that spurred the passage of the PSLRA in 1995 — including an abundance of frivolous suits, questionable claims of injury, and speculative theories of causation — prompted the adoption of Federal Rule of Evidence 702 and this Court's holding in *Daubert*.

Both *Daubert* and Rule 702 address the need to ensure that the nexus between a plaintiff's injury and the alleged cause of that injury is supported by reliable evidence. Prior to *Daubert*, courts viewed relevancy under a loose standard that tolerated almost any correlation between cause and injury. Without a rigorous examination of the causal nexus underlying the allegations, "marginal or unreliable" theories of causation regularly proceeded to trial. *See* Kenneth R. Foster et al., *Phantom Risk: Scientific Inference and the Law* 433 (1993).

Daubert and Rule 702 provided courts with the tools to screen out scientifically questionable claims in two ways. First, *Daubert* allowed courts to determine whether a claim is based on a proper temporal logic, where the alleged harmful act precedes the alleged injury. Second, *Daubert* required plaintiffs to exclude other factors, beyond the alleged harmful act, that could have caused their alleged injuries. Together, these guideposts "invite[d] courts to take a hard look" at the causal basis underlying a plaintiff's alleged injury and thus to "act with dispatch" in rejecting speculative, unproven, and unprovable damages claims. Christopher B. Mueller & Laird C. Kirkpatrick, *Evidence* § 7.17, at 740 (2d ed. 1999).

Loss causation under the PSLRA, as interpreted by other circuit courts, achieves this same goal in the securities context. By subjecting securities claims to the requirement of a decline in stock price close in time to the disclosure of the alleged fraud, courts are able to test for

some reliable indication whether plaintiffs' alleged damages were caused by fluctuations in the marketplace due to causes other than the defendant's putative fraud. Like the gatekeeping function endorsed in *Daubert*, the loss causation requirement helps to screen out securities fraud actions built upon "phantom" injuries — cases involving actual harms producing actual suffering, but for which no single cause can be reliably identified. *See* Foster, *Phantom Risk* 1.

Judge Easterbrook has discussed exactly this point in the class certification context, noting that, unless courts insist on a firm "causal link between non-public information and securities prices," they are left with only a "clash" of experts, a situation that amounts "to a delegation of judicial power to the plaintiffs, who can obtain class certification just by hiring a competent expert," leaving defendants subject to damages that have not been — and cannot be — "verified empirically." *West*, 282 F.3d at 938-40.

Such a result, invited by the Ninth Circuit's reasoning, defies the "universal requirement" that any claim sounding in tort must include a sufficient allegation that the defendant's conduct caused the plaintiff's injury, or, stated simply, "[n]o hurt, no tort." *Bastian*, 892 F.2d at 683-84; *see also* Guido Calabresi, *Concerning Cause and the Law of Torts: An Essay for Harry Kalven, Jr.*, 43 U. Chi. L. Rev. 69, 79 (1975). And without a hard look by the courts to ensure "some reasonable connection between the act or omission of the defendant and the damage which the plaintiff has suffered," Keeton, *Prosser and Keeton on Torts* § 41, at 263, litigants risk being exposed to "infinite liability for all wrongful acts," no matter how loosely connected or unrelated such conduct may be to the actual performance of a shareholder's investment, *id.* at 264. There is no reason to presume that Congress sought to endorse such a rule, so alien to traditional tort principles and this Court's holdings in *Daubert* and its progeny,

when it codified the loss causation requirement in the securities fraud arena.

D. The Ninth Circuit's rule, if permitted to stand, will also serve to chill investment advice and reporting and the free flow of information in our capital markets. To date, securities class actions typically have been aimed at issuers and their executives. But without a requirement that plaintiffs tie any alleged disclosure to a timely market effect, no apparent barrier will remain to prevent future litigants from bolder attempts to expand liability to anyone even remotely connected to an investment decision. So long as the market price of a stock is deemed to take account of the communication at issue pursuant to the efficient market hypothesis endorsed in *Basic Inc. v. Levinson*, 485 U.S. 224 (1988), investor reliance on that communication is presumed and dissatisfied investors are free to bring class action claims on them. *See Bastian*, 892 F.2d at 685. Accordingly, *any* allegedly false investment information from any source — not just issuers — could conceivably become the basis for triggering liability to *all* investors.

For example, media programs with "talking heads" have become a popular feature on cable television.[20] Internet sites such as "The Motley Fool" also regularly praise investments like Dura Pharmaceuticals. And, of course, investment banks make buy and sell recommendations. Without a legal rule limiting the scope of liability to disclosures that bear a close causal link with specific stock price declines, dissatisfied investors could conceivably bring claims against such sources simply by finding some false statement recommending a stock made before a wide public audience. *See Bastian*, 892 F.2d at 685.

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[20] *See, e.g.*, CNN, *CNNfn on TV*, *at* http://money.cnn.com/ontv; FOXNews.com, *FNC Shows*, *at* http://www.foxnews.com/business; CNBC, CNBC TV, *at* http://moneycentral.msn.com/cnbc/tv/default.asp.

To avoid this consequence, corporations — along with investment firm stock analysts, media sources touting stocks, and others — will have a strong incentive to limit their discussions to the narrowest possible scope, or cease publishing information on stocks altogether. Such a result, of course, is inconsistent with the very premise of an open capital market, which depends on the freest possible flow of information. *See* Posner, *Economic Analysis of the Law* 457-58 (explaining that "[i]nformation that may mislead some members of the audience may be valuable to others"); *see also Securities Fraud on the Internet: Hearings Before the Permanent Subcomm. on Investigations of the Senate Comm. on Government Affairs*, 106th Cong. 79-91 (Mar. 22-23, 1999) (testimony of Thomas M. Gardner, founder of The Motley Fool, Inc.), *available at* 1999 WL 8085871 ("We believe that technology, especially the Internet, allows people to obtain information that once was the exclusive property of Wall Street professionals, so that they can make their own financial decisions better than the professionals they previously relied upon.").

CONCLUSION

The decision of the court of appeals should be reversed.

Respectfully submitted,

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